

April 16, 2002



Audit Oversight

Defense Contract Audit Agency
Regional Quality Assurance Review
of the Incurred Cost Sampling
Initiative
(D-2002-6-005)

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Acronyms

ADV	Auditable Dollar Volume
CAM	DCAA Manual 7640.1, "DCAA Contract Audit Manual"
DCAA	Defense Contract Audit Agency
ESC	Executive Steering Committee
FAO	Field Audit Office
GAS	Government Auditing Standards
MRD	Memorandum for Regional Directors
PCIE	President's Council on Integrity and Efficiency
RQA	Regional and Field Detachment Quality Assurance Division



INSPECTOR GENERAL
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April 16, 2002

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY

SUBJECT: Report on the Defense Contract Audit Agency Regional Quality Assurance Review of the Incurred Cost Sampling Initiative (Report No. D-2002-6-005)

We are providing this report for information and use. We considered management comments on a draft of this report in preparing the final report.

Comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the evaluation staff. For additional information on this report, please contact Mr. Wayne C. Berry at (703) 604-8789 (DSN 664-8789) (wberry@dodig.osd.mil) or Ms. Diane H. Stetler at (703) 604-8737 (DSN 664-8737) (dstetler@dodig.osd.mil). See Appendix B for the report distribution. The team members are listed inside the back cover.

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Report No. D-2002-6-005

(Project No. D2000OA-0238.01)

April 16, 2002

Defense Contract Audit Agency Regional Quality Assurance Review of the Incurred Cost Sampling Initiative

Executive Summary

Introduction. This is the second in a series of reports on the Defense Contract Audit Agency quality assurance program. For our first report, we issued Report No. D-2002-6-001, December 6, 2001, "Defense Contract Audit Agency Quality Assurance Program," that assessed the adequacy of the overall quality assurance program and the quality assurance review of forward pricing assignments. The Defense Contract Audit Agency Executive Steering Committee tasked the regional and Field Detachment Quality Assurance Divisions to conduct an initial review and a followup review of the implementation of the incurred cost sampling initiative for contractors with auditable dollar volume of \$10 million or less. The sampling initiative uses audit experience to stratify those contractors into two groups: high-risk contractors that would be audited annually and low-risk contractors that would be audited at least once every three years based on a prior audit history of little or no cost questioned or other audit leads. In FY 2000, the sampling initiative covered about 3,500 incurred cost audit submissions worth almost \$7 billion. The sampling initiative is designed to redirect audit effort from low-risk contractors to high-risk audit areas.

Objectives. The objective was to determine whether the Defense Contract Audit Agency regional and Field Detachment Quality Assurance Divisions' reviews of the implementation of the incurred cost sampling initiative provided reasonable assurance that the applicable established policies and procedures were followed for the sampling initiative program. Specifically, we assessed how the Defense Contract Audit Agency selected, staffed, and performed the regional and Field Detachment quality assurance reviews of the implementation of the sampling initiative.

Results. The regional and Field Detachment internal quality assurance reviews provided reasonable assurance that the incurred cost sampling initiative was implemented in accordance with established policies and procedures. The regional and Field Detachment FY 1999 internal quality assurance review of the sampling initiative properly identified major noncompliances with the established auditing policies and procedures, and the FY 2000 review performed timely followup on the issues identified by the initial review. The regional and Field Detachment quality assurance programs include aspects of the key characteristics needed for an effective review of an internal quality control system. However, additional improvements and enhancements through formalization of the regional and Field Detachment quality assurance policies and procedures, better documentation, and more complete cross-referencing of review

results would ensure that the regional and Field Detachment Quality Assurance Divisions operate as a more effective part of the overall quality assurance program, and would allow an external reviewer to place greater reliance on its work without retesting.

Summary of Recommendations. We recommend the Defense Contract Audit Agency require all corrective actions and followup procedures related to the regional and Field Detachment Quality Assurance Divisions joint reviews directed by the Executive Steering Committee are tracked until completion. We also recommend that the Defense Contract Audit Agency issue written regional and Field Detachment instructions for their respective quality assurance divisions and update the regional and Field Detachment quality control system descriptions to include the quality assurance division.

Management Comments. The Defense Contract Audit Agency concurred in principle to tracking corrective actions and followup procedures until completion, stating that organizational elements will be required to report the completion of corrective actions to the Executive Steering Committee, or other designated management officials, and that the process would be incorporated into a new instruction to be issued by May 30, 2002. The Defense Contract Audit Agency concurred with developing written policies and procedures and to update the quality control system descriptions, stating that each regional director will have either developed a new instruction or updated existing instructions by August 30, 2002. A discussion of management comments to the recommendations is in the Finding section of the report and the complete text is in the Management Comments section.

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Background

This is the second in a series of reports on the Defense Contract Audit Agency (DCAA) quality assurance program. The first report issued, Report No. D-2002-6-001, December 6, 2001, "Defense Contract Audit Agency Quality Assurance Program," assessed the adequacy of the quality assurance program and the first quality assurance review of forward pricing audits.

DCAA Organizations and Functions. DoD Directive 5105.38, "Defense Contract Audit Agency," June 9, 1965, establishes DCAA as a separate organization under the direction, authority, and control of the Under Secretary of Defense (Comptroller/Chief Financial Officer).¹ Organizationally, DCAA is divided into a headquarters, five regions, a Field Detachment, and 81 field audit offices (FAOs).² DCAA considers all organizational layers to be part of its internal quality control system. The primary mission of DCAA is to perform contract audits for DoD. For FY 2000, DCAA completed 41,722 audits valued at \$194.8 billion,³ with net savings of \$2.4 billion. DCAA incurred \$364.3 million in total operating costs. DCAA audit guidance is contained in DCAA Manual 7640.1, "DCAA Contract Audit Manual" (CAM).⁴ Specifically, CAM 2-101 states that the Government Auditing Standards (GAS) is applicable to DCAA. DCAA ensures compliance with applicable auditing standards throughout audit planning and performance activities by supplementing audit guidance in CAM with standard audit programs. Between semi-annual CAM updates, DCAA headquarters notifies managers of new and revised audit guidance by issuing Memorandums for Regional Directors (MRD) that are usually incorporated into the next CAM update.

Executive Steering Committee. The Executive Steering Committee (ESC) is responsible for providing overall management and direction for the DCAA total quality management program. In addition, ESC is responsible for establishing the DCAA vision and strategic goals, identifying quality improvement projects, evaluating quality improvement projects suggested by others, either approving or disapproving DCAA-wide process action teams, and maintaining active communication and coordination with the quality management boards regarding their process action team activities and recommendations. Its members include the director, deputy director, assistant directors of the headquarters components, regional directors of the five regions and Field Detachment, and general counsel. ESC meets quarterly, and it is briefed on the DCAA internal quality assurance program among other issues. If necessary, ESC establishes

¹Formerly the Assistant Secretary of Defense (Comptroller)

²An FAO can be either a resident office or a branch office. A resident office is established at a contractor's facility whenever the amount of audit work justifies the assignment of a permanent staff of auditors and support elements. A branch office, which performs the work at several contractor facilities, is not located in a contractor's facility.

³This represents dollars examined or reviewed by DCAA for forward pricing assignments, incurred cost audits, and special audits; for example, terminations, claims, and Government facility rentals.

⁴DCAA Manual 7640.1 is updated every six months. As of December 2001, the most recent version was July 2001.

action items for tasks to be completed or information to be provided as a result of the internal quality assurance briefings. A listing of action items is maintained by the Executive Officer for the Director, DCAA.

DCAA Internal Quality Control System. The DCAA internal quality control system encompasses the agency's organizational structure, and it is an important subset of the DCAA total quality management program. The DCAA internal quality control system is implemented at all levels of the organization. It is multifunctional and covers elements of vulnerability assessment, internal control review, external audit followup,⁵ audit quality review, and management improvement efforts.

Requirement for Internal Quality Control System. GAS, issued by the Comptroller General of the United States, requires that each audit organization have an appropriate quality control system. The objective of an internal quality control system is to provide reasonable assurance that established policies, procedures, and auditing standards are followed. An organization's internal quality assurance program is an important part of its quality control system.

Incurred Cost Sampling Initiative. DCAA proposed the sampling initiative in FY 1994 as a means to redirect audit effort from small, low-risk incurred cost audits to higher risk audit areas and reduce the incurred cost audit backlog that existed at that time. In August 1995, DCAA issued audit guidance implementing the initiative. The sampling initiative originally covered annual incurred cost submissions with auditable dollar volume (ADV) of \$5 million or less. For FY 1999, DCAA expanded the program to include annual incurred cost submissions with ADV of \$10 million or less.

CAM provides guidance on how FAOs should implement the sampling initiative. A contractor's incurred cost submission is either classified as high-risk or low-risk. A submission is categorized as low-risk when the audit of the prior year's submission disclosed no significant questioned costs, no audit leads existed with a high probability of significant questioned costs, the contracting officer did not request an audit identifying significant audit risk, and DCAA has previously performed incurred costs audits at the contractor. Submissions not meeting the requirements for low-risk are automatically considered high-risk and are scheduled for audit. All low-risk submissions are put into a FAO-wide pool from which one-third are randomly selected for audit. FAO performs a desk review on the remaining two-thirds. In addition, FAO is required to audit a contractor's submission at least once every three years, no matter how it is categorized. In FY 2000, the sampling initiative covered approximately 3,500 incurred cost audit submissions worth about \$7 billion.

Regional Quality Assurance Review of the Sampling Initiative. In March 1998, ESC tasked the staff of the Assistant Director, Policy and Plans, DCAA, to team with the regions to perform an evaluation of current practices in

⁵This includes activities related to external audit organizations, such as the General Accounting Office and the DoD Inspector General.

the low-risk arena to determine the need for additional guidance. Senior management from the regional and Field Detachment⁶ Quality Assurance Divisions (RQA)⁷ met in December 1998 and proposed a DCAA-wide RQA project on the sampling initiative to ESC, which was approved. By that time, some regions had already identified compliance issues involving implementation of the sampling initiative and three regions had planned or started a review. It was the first time ESC directed RQAs to perform a joint DCAA-wide review. In FY 1999, RQAs performed the initial DCAA-wide review of the implementation of the sampling initiative. RQAs presented the results to ESC at the September 1999 meeting. Based on the results of the initial review, ESC tasked RQAs to conduct a followup DCAA-wide project to determine whether FAOs previously reviewed had corrected the identified deficiencies. The RQA representatives presented the results of the followup review to ESC at the September 2000 meeting and concluded that an overall acceptable level of compliance had been reached. RQAs identified two noncompliance areas; administrative contracting officer notification and billing rate adjustment, for which DCAA planned to issue revised guidance. Based on that briefing, ESC decided that no further DCAA-wide followup was needed.

Objectives

The overall evaluation objective was to determine whether the RQA reviews of the implementation of the incurred cost sampling initiative for contractors with ADV of \$10 million or less provides reasonable assurance that applicable established policies and procedures were followed for the sampling initiative program. Specifically, we assessed how DCAA selected, staffed, and performed the RQA reviews of the implementation of the sampling initiative. See Appendix A for a discussion of the evaluation scope, methodology, and prior coverage.

⁶Field Detachment is responsible for the overall planning, management, and execution of worldwide DCAA contract audits of compartmented programs.

⁷The Field Detachment Quality Assurance Division operates in essentially the same manner as an RQA; therefore, in this report, when we refer to an RQA we are including the Field Detachment Quality Assurance Division.

Regional and Field Detachment Quality Assurance Programs

The regional and Field Detachment internal quality assurance reviews provided reasonable assurance that the sampling initiative was implemented in accordance with established policies and procedures. The regional and Field Detachment FY 1999 internal quality assurance review of the sampling initiative properly identified major noncompliances with the established auditing policies and procedures, and the FY 2000 review performed timely followup on the issues identified by the initial review. The DCAA regional and Field Detachment quality assurance programs were established to complement the headquarters quality assurance program in providing reasonable assurance that DCAA has a comprehensive quality control system that follows applicable auditing standards and has established and follows adequate audit policies and procedures. The regional and Field Detachment quality assurance programs include aspects of the key characteristics needed for an effective review of an internal quality control system. However, additional improvements and enhancements through formalization of the regional and Field Detachment quality assurance policies and procedures as well as better review documentation would ensure that RQAs operate as a more effective part of the overall DCAA quality assurance program, and would allow an external reviewer to place greater reliance on the internal quality assurance work performed by RQAs without retesting.

Structure of DCAA Quality Assurance Program

DCAA Quality Assurance Program. DCAA MRD 98-P-147(R), “Establishment of Quality Assurance Division,” October 23, 1998, established a Quality Assurance Division at DCAA headquarters and in each of the five regions and Field Detachment. RQAs are responsible for developing and executing an agency-wide program to provide reasonable assurance that DCAA has adopted and follows applicable auditing standards, and that DCAA has established and follows adequate auditing policies and procedures. Additional functions include assessing the need for new or revised guidance, supporting external quality control reviews, accompanying external auditors on field visits, serving on process action teams, assisting in responding to inquiries, and identifying “best-in-class” processes for DCAA-wide use.

Headquarters Quality Assurance Division. The DCAA headquarters Quality Assurance Division performs formal internal quality assurance reviews and other quality assurance-related reviews on a DCAA-wide basis using criteria derived from the “Guide for Conducting External Quality Control Reviews of the Audit Operations of Offices of the Inspector General” (PCIE Guide),

April 1997, developed by the President's Council on Integrity and Efficiency (PCIE).⁸ When conducting the reviews, the headquarters Quality Assurance Division assesses compliance with applicable auditing standards and audit policies and procedures, the need for enhanced or new audit policy guidance, and best practices for agency-wide use.

Regional and Field Detachment Quality Assurance Divisions. RQAs assist the DCAA headquarters Quality Assurance Division in performing formal internal quality assurance reviews, in addition to conducting independent quality assurance reviews of regional policies and procedures. RQAs can be directed to perform regional internal quality assurance reviews by either the regional director or ESC. The ESC can direct RQAs to jointly perform internal quality assurance reviews on an agency-wide basis when DCAA management determines that the audit area merits such a review. For ESC-directed reviews, RQAs assess compliance with applicable DCAA policies and procedures, the need for enhanced or new agency-wide guidance, or best practices for agency-wide use. When conducting regional internal quality assurance reviews, RQAs assess compliance with applicable regional policies and procedures, the need for enhanced or new regional guidance, and best practices for regional use. RQAs also perform special reviews as required by the regional directors. RQAs report to the regional directors rather than the DCAA headquarters Quality Assurance Division; however, for ESC-directed reviews, RQAs report the results of the review to ESC.

DCAA Regional and Field Detachment Quality Assurance Programs

The PCIE Guide describes the characteristics that an organization's quality assurance program should integrate into any review of its quality control system. Those characteristics include formal quality assurance review procedures, adequate staffing, independence, thorough scope of review, sufficient evidence, written results, written responses, and an effective followup process. The DCAA regional and Field Detachment quality assurance programs contain elements of each of those characteristics. For staffing, independence, and scope of review, the regional and Field Detachment quality assurance programs meet the intent of the PCIE Guide. However, additional improvements and enhancements in formal quality assurance review procedures, evidence, written reports and responses, and followup process would ensure that RQAs operate as a more effective part of the overall DCAA quality assurance program. The characteristics of the DCAA regional and Field Detachment quality assurance programs need improvement or enhancement in order for an external reviewer to place greater reliance on the internal quality assurance work performed by RQAs.

⁸The PCIE was established to identify, review, and discuss areas of weakness and vulnerability in Federal programs and operations; to develop plans for coordinated, Government-wide activities that address those issues; and to promote economy and efficiency in Federal programs and operations. Although it does not affect this review, the PCIE Guide was revised on January 4, 2002.

Formal Quality Assurance Review Procedures. Organizations conducting internal quality assurance reviews should have formal policies and procedures. None of the RQAs had formal policies and procedures describing how the internal quality assurance reviews would be conducted. As of December 20, 2001, two regions (Central and Western) revised the regional quality control system instruction to include the recently formed RQAs. A third region (Eastern) revised its instruction on the Total Management Control Program to include its RQA. In order to document the role that RQAs serve in the regional quality control system, the regional instructions should be revised. In addition, because RQAs perform various reviews depending on the requester, the regions should issue formal, written policies and procedures that describe responsibilities, functions, review reporting, and documentation requirements.

Staffing. Internal quality assurance review teams should be led by a senior manager, and the reviewers should have an appropriate level of experience. Each RQA staff consists of one GS-14 supervisor and four GS-13 auditors. Each RQA staff reports to a regional director. DCAA requires that quality assurance staffs comply with continuing professional education requirements in GAS. The RQA staffing appears adequate to perform the quality assurance review function as currently envisioned.

Independent Review. The review team leader should report to an individual or a level within the organization that would ensure independence and objectivity of the performance of internal quality assurance reviews. Auditors assigned to RQAs generally report to the regional directors rather than the headquarters Quality Assurance Division except when performing headquarters-led internal quality assurance reviews. In addition, when performing ESC-directed reviews, a briefing is provided to ESC. Therefore, the organizational independence of RQAs is appropriate to accomplish the intended mission.

Scope of RQA Reviews. The scope of the internal quality assurance reviews should include a determination on the degree of compliance with applicable auditing standards, policies and procedures, internal quality control policies and procedures, and other statutory or regulatory guidance. In addition, an internal quality assurance program should cover all audit offices issuing audit reports and an appropriate cross-section of the types of audits performed.

Initial Review. Each RQA review covered the same general objective: evaluate, test, and report on the effectiveness of the sampling initiative during FY 1999. RQAs coordinated a checklist used during the review. RQAs used the checklist to determine whether the incurred cost submissions were appropriately assessed for risk, accurately classified as either high-risk or low-risk, and properly audited or desk reviewed. As part of the review, RQAs evaluated the relevant FAO procedures. RQAs separately establish the criteria for selecting FAOs in the respective regions for review. In total, RQAs reviewed the implementation of the sampling plan of 38 FAOs.

Followup Review. The objective of the followup review was to evaluate, test, and report on the effectiveness of the corrective actions taken by FAOs for implementing the sampling initiative. RQAs determined that the followup review should cover four common deficiencies identified during the initial review:

- low-risk database not created and/or updated,
- problems selecting low-risk sample,
- inadequate documentation for basis of risk classification, and
- CAM specified desk review procedures not being followed.

RQAs coordinated the checklists used for the followup review. However, as in the initial review, each RQA established its own FAO selection criteria. In total, RQAs visited 39 FAOs, 31 of the FAOs had been visited during the initial review and 8 had not. In conclusion, RQAs established an acceptable scope to accomplish the stated objectives for both reviews. The checklists adequately covered the applicable DCAA policies and procedures. The 46 FAOs⁹ reviewed provided the appropriate coverage to accomplish the stated objectives of the initial and followup reviews.

Evidence. Competent evidential matter should be gathered and, where applicable, sufficient testing should be accomplished to determine whether the organization is in compliance with applicable auditing standards, policies, and procedures. Each RQA determined the amount of testing needed for the preliminary risk assessments and desk reviews at FAOs. Therefore, each RQA gathered what it considered to be sufficient evidence to evaluate whether its auditors complied with applicable auditing policies and procedures. However, we were unable to rely on the RQA work without retesting because of the lack of sufficient documentation.

RQAs were not required to follow any specific documentation standards, such as GAS, when performing internal quality assurance reviews. Explanations in the RQA review documentation were not always sufficient for an external reviewer to understand the rationale behind the conclusions. For example, RQA reviewers did not always document the reason for a “yes,” “no,” or “not applicable” answer. In some cases, for certain questions the reason was obvious usually because of the answer to a previous question. However, for other questions, some RQA reviewers could have provided more written support for the answers either by referencing a working paper from the FAO file or providing a more detailed explanation in the comments column.

Also, the RQA reviewers did not always document why items selected for review were not reviewed. For instance, in one RQA review, 14 reviews were initially selected, but it was unclear why the RQA reviewer did not look at 1 of the items. For another RQA review, the initial selection was 10, however, only 9 were reviewed. The reviewer dropped one from the initial selection and

⁹The 46 FAOs are comprised of the 38 FAOs reviewed during the initial review and the 8 additional FAOs reviewed during the followup but not reviewed initially.

included a different item. The documentation did not explain why the substitution was made. Additional documentation is needed for an external reviewer to be able to place reliance on the RQA work without retesting or with minimal retesting.

In addition, review documentation was not always cross-referenced to supporting documentation in the FAO files. Such cross-referencing would have facilitated external review. Issuance of formal, written policies and procedures should address documentation expectations for regional quality assurance reviews.

Written Results and Responses. Written results should be prepared for each review and, when applicable, should include recommendations for corrective actions. In addition, written responses to the written results should be obtained on each recommendation to include the proposed corrective actions or the corrective actions already taken. RQAs summarized all of the regional reports and presented consolidated briefings to ESC for the initial review in September 1999 and the followup review in September 2000. The charts that RQAs used to brief ESC on the initial and followup reviews included recommendations for corrective action. The briefing charts used by RQAs contained sufficient detail and met the intent of a written report and response. Each RQA issued a report to the regional director summarizing the region-wide results, corrective actions, and best practices found at various FAOs. However, each reviewed RQA followed a slightly different procedure in providing individual review results to FAOs. One RQA prepared memorandums for the FAO managers summarizing the results of the review at each FAO in the region and included the FAO response as an attachment. Another RQA provided a more formal report with the FAO response attached. A third RQA provided a copy of the reviewer's exit notes as well as the summary working paper for the review to FAO. Providing written documentation of the conditions at the FAO level and obtaining written FAO responses with corrective action plans would facilitate implementation of corrective actions and would enhance the RQA review process.

Followup Process. Procedures should be established for resolution and followup of recommended corrective actions. A good followup system should provide information on what improvements were made as a result of the work and whether the improvements achieved the desired result. Determining actions taken on recommendations requires active monitoring of the status of recommendations. DCAA has two separate followup processes for monitoring the status of actions taken as a result of RQA reviews. The followup process used depends on whether the review was DCAA-wide or region specific. For DCAA-wide reviews, any corrective action adopted by ESC is assigned an action item number and it is included in a database maintained by the Executive Officer for the Director, DCAA. For region specific reviews or region specific issues identified by a DCAA-wide review, the RQA reports to the regional director and it is solely responsible for any followup deemed necessary.

As discussed in Inspector General, DoD, Report No. D-2002-6-001, "Defense Contract Audit Agency Quality Assurance Program," December 6, 2001, and agreed to by DCAA, DCAA should formalize a coordinated followup process for ESC-directed reviews and ESC-approved corrective actions.

ESC-Directed Followup. For ESC-directed RQA reviews, regional directors should be required to notify the headquarters Quality Assurance Division when all corrective actions have been completed. As part of this process, ESC should define when corrective actions would be considered completed for purposes of the ESC-directed review. For instance, after RQAs briefed ESC on the results of the initial review, ESC directed RQAs to perform followup on certain key findings. The action helped ensure that the regions and FAOs would emphasize correction of the identified deficiencies in a timely manner. However, after the RQA briefing for the followup review, ESC determined that no further ESC-directed followup was needed because the RQA review found an overall acceptable level of compliance with existing DCAA policies. However, RQAs had still identified locations where the sampling initiative was not properly implemented. The review did identify two areas where significant noncompliance still existed; however, DCAA headquarters was in the process of revising audit guidance to help prevent future noncompliances. Headquarters issued the relevant guidance in MRD 00-PPD-108(R), December 28, 2000.

RQA Followup. After the ESC-directed followup was completed, RQAs separately determined what, if any, further followup at FAOs was required to ensure proper implementation. Therefore, one RQA might consider that no additional followup was needed even though a reviewed FAO still needed to improve its implementation of the sampling initiative. Another RQA might decide to continue to review FAO until it could verify that FAO had fully implemented the sampling initiative.

Because ESC tasked RQAs to conduct the review of the sampling initiative, the final closeout of any regional followup actions should be tracked by headquarters. The regions should be required to notify headquarters how they will define closeout on the joint review and when the followup actions are completed. Without tracking the regional followup actions, headquarters will not know or understand how the regions have completed the followup process. The tracking process could be described in the formal, written policies that DCAA has already agreed to write for the headquarters Quality Assurance Division.

Results of Inspector General, DoD, Retesting

RQAs generally answered the review checklist questions correctly, properly identified major noncompliances with DCAA policies and procedures, and performed timely followup on the agreed-to FAO corrective actions. Therefore, the RQA reviews of the sampling initiative provide reasonable assurance that the applicable DCAA audit policies and procedures were being followed. However, future RQA internal quality assurance reviews could be enhanced by improving the documentation of the review performed and by more thoroughly cross-referencing the results to the supporting documentation. In addition, the overall effectiveness of the RQA programs would be improved by documenting

procedures in formal, written regional policies and procedures. Implementation of suggested improvements and enhancements would enable external reviewers to place greater reliance on the RQA work without retesting.

Recommendations and Management Comments

1. We recommend that the Director, Defense Contract Audit Agency, issue policy requiring all corrective actions and followup procedures related to regional and Field Detachment Quality Assurance Divisions joint reviews directed by the Executive Steering Committee are tracked until final completion.

Management Comments. DCAA concurred in principle, stating that ESC will require DCAA organizational elements to report the completion of action items to the designated DCAA management officials. In addition, the DCAA headquarters Quality Assurance Division will be the focal point for advising the DCAA Director and ESC on the status of action items related to the DCAA Quality Assurance Program. DCAA plans to issue a new instruction, which will include the followup process, by May 30, 2002.

2. We recommend that the Regional Directors and the Director, Field Detachment, Defense Contract Audit Agency:

a. Develop written policies and procedures that formalize respective regional quality assurance division responsibilities, policies, procedures, functions, review reporting and documentation requirements, including cross-referencing, and followup procedures.

b. Update the quality control system description to include the quality assurance division.

Management Comments. DCAA concurred, stating that each regional director and the Field Detachment Director will either develop a new instruction or significantly revise existing quality control instructions to cover the responsibilities of the quality assurance divisions and related policies, procedures, functions, review reporting, and documentation requirements by August 30, 2002.

Appendix A. Evaluation Process

Scope

An audit organization's internal quality assurance program is an integral part of its overall management control program. We based our review on GAS standards relating to quality control and DCAA policies and procedures in force during FYs 1999 and 2000. In addition, we used the PCIE "Guide for Conducting External Quality Control Reviews of the Audit Operations of Offices of the Inspector General," April 1997, specifically Appendix C, "Checklist for Assessment of Internal Quality Assurance Program;" Appendix D, "Checklist for Review of Internal Quality Assurance Reports;" and Appendix I, "Policy Statement on Internal Quality Control and External Quality Control Review." We evaluated the RQA initial reviews of the implementation of the sampling initiative performed in FY 1999 and the followup review performed in FY 2000. For both reviews, we reviewed the RQA coordination process, the review programs and checklists used, the FAO selection process, the summary RQA reports issued to the Regional and Field Detachment Directors, the ESC briefing charts summarizing the combined review results and recommendations, and the corrective action followup performed. We visited three FAOs (Fairfax Branch Office in Virginia, Houston Branch Office in Texas, and the Mid-Atlantic Branch Office in Maryland) in three of the six regions (Mid-Atlantic Region, Central Region, and Field Detachment) to retest the RQA work and conclusions. We discussed the review process, findings, and conclusions with the regional and Field Detachment Quality Assurance Division Chiefs and team members. In addition, we reviewed regional and Field Detachment policies and procedures relating to RQAs in order to evaluate the regional and Field Detachment quality assurance programs in total and to determine how much reliance we could place on the process when conducting our oversight reviews.

Inspector General, DoD, Oversight Responsibilities. Under section 8(c)(6), title 5, United States Code, Appendix 3, the Inspector General Act of 1978, as amended, the Inspector General, DoD, is responsible for monitoring and evaluating adherence of DoD auditors to internal audit, contract audit, and internal review principles, policies, and procedures. The office within the Inspector General, DoD, responsible for conducting independent oversight reviews of DCAA is the Office of the Assistant Inspector General for Auditing, Deputy Assistant Inspector General for Audit Policy and Oversight. As part of the oversight reviews, Audit Policy and Oversight evaluates the internal quality assurance reviews performed by the DCAA headquarters Quality Assurance Division and RQAs. Audit Policy and Oversight uses the PCIE Guide as a tool when conducting its oversight reviews.

Methodology

To evaluate the adequacy of the RQA reviews of the sampling initiative, we conducted interviews with the RQA personnel to determine the procedures used

to conduct the internal quality assurance reviews. To evaluate the results of the reviews, we evaluated the RQA review documentation to determine that significant noncompliances were found and reported. We selected three FAOs that RQAs had reviewed during both the initial and followup reviews. Therefore, we retested approximately 8 percent¹⁰ of the RQA work. We reviewed the sampling plans, preliminary risk assessments, and desk reviews using the same criteria that RQAs used during their reviews. We compared our results to the RQA results, identified any differences, and determined why the differences existed. In addition, we determined whether corrective actions had been implemented after the followup review by reviewing the FAO documentation and files generated after the followup review when available and relevant. Also, we determined whether sufficient evidence existed in the review file to support reviewer judgments, specifically, whether the RQA results were adequately cross-referenced to supporting documentation and sufficient explanations were provided for checklist responses.

Use of Computer-Processed Data. We did not use computer-processed data to perform the evaluation.

Evaluation Dates and Standards. We conducted this oversight review from November 2000 through March 2002 in accordance with standards issued and implemented by the Inspector General, DoD. The project was suspended from June 15, 2001 to August 24, 2001.

Contacts During the Evaluation. We visited or contacted individuals and offices within DoD. Further details are available upon request.

Prior Coverage

Inspector General, DoD

Inspector General, DoD, Report No. D-2002-6-001, "Defense Contract Audit Agency Quality Assurance Program," December 6, 2001

Inspector General, DoD, Report No. D-2000-6-010, "External Quality Control Review of the Defense Contract Audit Agency," September 27, 2000

¹⁰For the initial review, 3 out of 38 RQA-reviewed FAOs equal 8.89%. For the followup review, 3 out of 39 RQA-reviewed FAOs equal 7.69%.

Inspector General, DoD, Report No. PO 97-032, "Evaluation of Defense Contract Audit Agency Sampling Initiative of Incurred Cost Proposals on Low-Risk Contractors," June 27, 1997

Appendix B. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)

Other Defense Organization

Director, Defense Contract Audit Agency

Defense Contract Audit Agency Comments



DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
8725 JOHN J. KINGMAN ROAD, SUITE 2135
FORT BELVOIR, VA 22060-4219

IN REPLY REFER TO

PQA 225.4[D2000OA-0238.01]

March 27, 2002

MEMORANDUM FOR DEPUTY ASSISTANT INSPECTOR GENERAL FOR AUDIT
POLICY AND OVERSIGHT, DEPARTMENT OF DEFENSE,
INSPECTOR GENERAL

SUBJECT: Response to Draft Oversight Report on the DCAA Regional Quality Assurance
Review of the Incurred Cost Sampling Initiative (Project No. D2000OA-0238.01)

Thank you for the opportunity to comment on the subject report. In general, we think the report fairly presents the review that was performed and the results of that review. Our comments on the report recommendations are provided below.

DoDIG Report Recommendation No. 1

1. We recommend that the Director, Defense Contract Audit Agency, issue policy requiring all corrective actions and followup procedures related to regional and Field Detachment Quality Assurance Divisions joint reviews directed by the Executive Steering Committee are tracked until final completion.

DCAA Comments

Concur in principle. For the future, when DCAA's Executive Steering Committee (ESC) establishes an action item related to the review work of the Agency's Quality Assurance (QA) organization, the ESC will require the performing organizational element(s) to report or present in a clear manner THE CLOSURE of the action item to DCAA's Director, the ESC, or other DCAA management official, as designated by DCAA's Director or the ESC. The Headquarters Quality Assurance Division (PQA) will serve as the focal point for advising the Director and the ESC on the status of the QA-related action items and for answering inquiries on the action items. A new DCAA Instruction (DCAAI 7640.20) on the Quality Assurance Program to be issued by May 30, 2002 will incorporate the preceding process changes and clarifications.

PQA 225.4[D2000OA-0238.01]

SUBJECT: Response to Draft Oversight Report on the DCAA Regional Quality Assurance
Review of the Incurred Cost Sampling Initiative (Project No. D2000OA-0238.01)

DoDIG Report Recommendation No. 2a & 2b

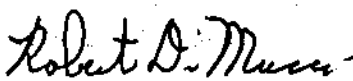
2. We recommend that the Regional Directors and the Director, Field Detachment, Defense Contract Audit Agency:

- a. Develop written policies and procedures that formalize respective regional quality assurance division responsibilities, policies, procedures, functions, review reporting and documentation requirements, including cross-referencing, and followup procedures.
- b. Update the quality control system description to include the quality assurance division.

DCAA Comments

Concur. Each Regional Director (RD) and the Field Detachment Director (FDD) by August 30, 2002 will have either developed a new instruction or significantly revised their existing *Quality Control* instructions to cover the responsibilities of their respective *Quality Assurance* (QA) Divisions and the related QA policies, procedures, functions, review reporting and documentation requirements. Those regions developing a new QA instruction (if any), will also update their existing *Quality Control* instructions to include an appropriate description of the QA Division and a reference to the new QA instruction.

Questions regarding this memorandum should be directed to Mr. Henry Simpkins, Quality Assurance Division at (703) 767-2250.


For Lawrence P. Uhlfelder
Assistant Director
Policy and Plans

Team Members

The Deputy Assistant Inspector General for Audit Policy and Oversight, Office of the Assistant Inspector General for Auditing, DoD, prepared this report. Personnel of the Office of the Inspector General, DoD, who contributed to the report, are listed below.

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